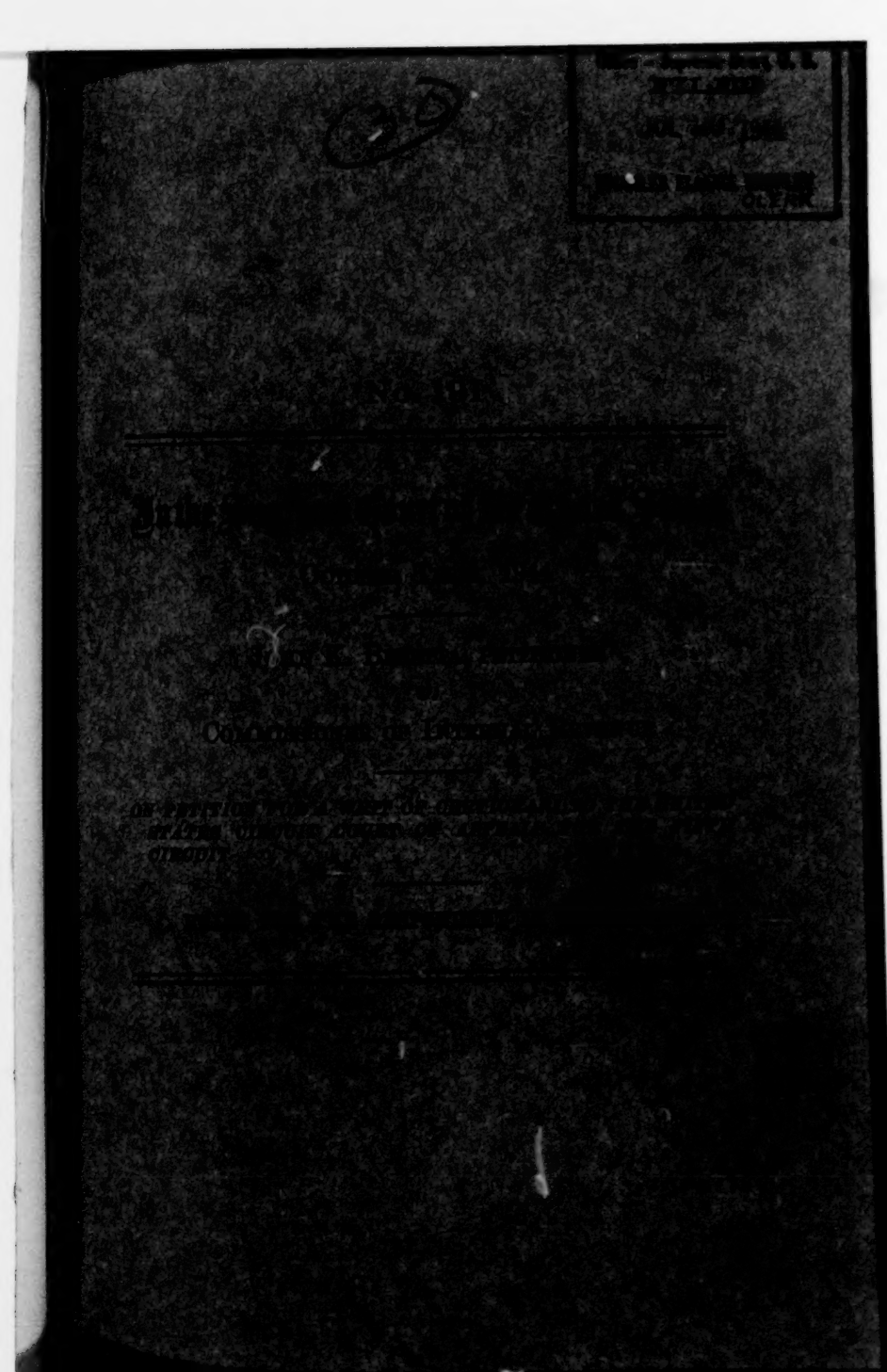

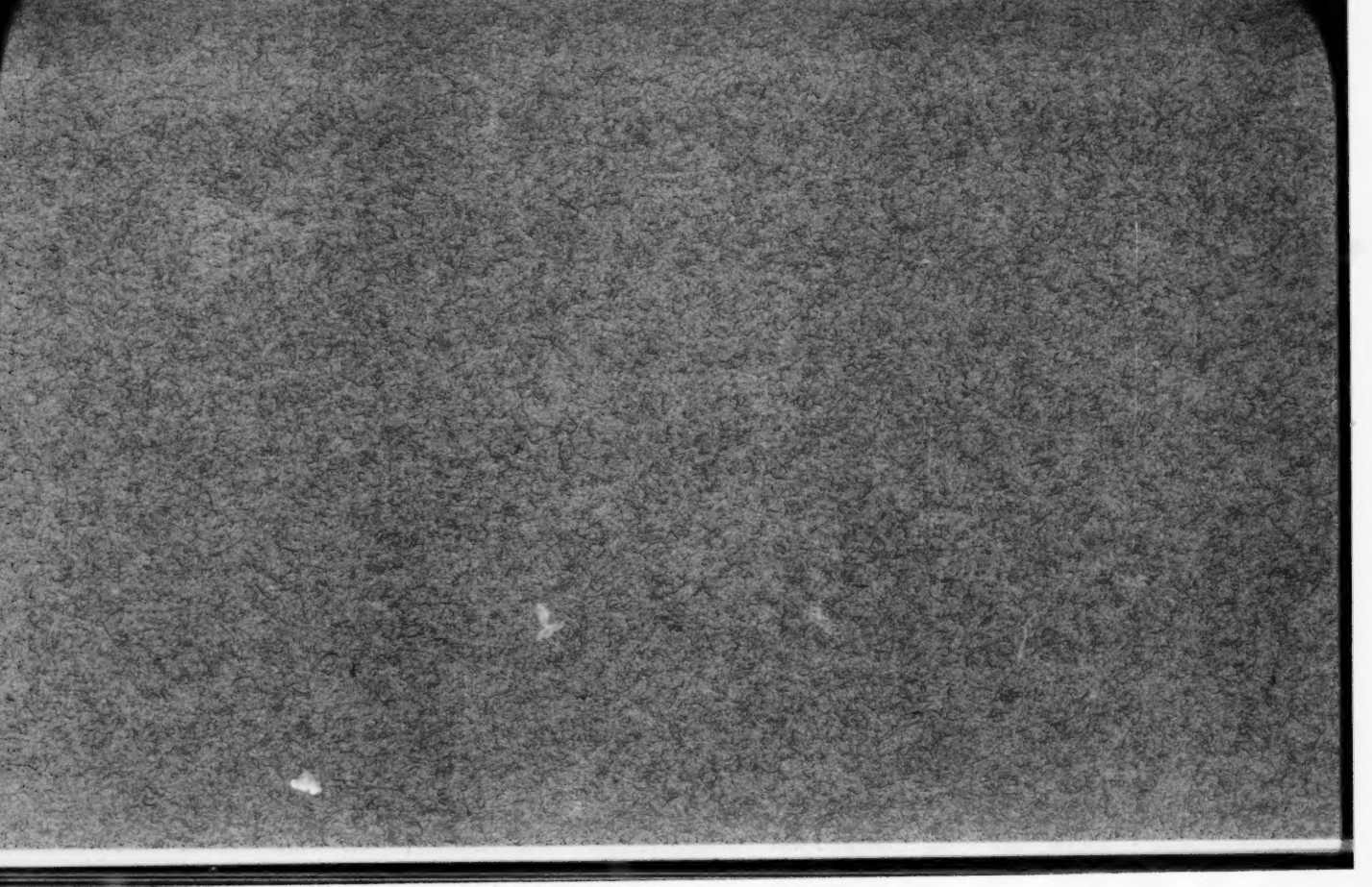

INDEX

CITATIONS

599505—44——1

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 191

JOHN K. BERETTA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17–41) is reported at 1 T. C. 86. The opinion of the Circuit Court of Appeals (R. 87–93) is reported at 141 F. 2d 452.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 3, 1944 (R. 94). A petition for rehearing was denied on March 25, 1944 (R. 101). The petition for a writ of certiorari was filed on June 24, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a distribution by a corporation to its stockholders was an ordinary dividend, or a distribution in partial liquidation of the corporation under Section 115 (c) and (i) of the Revenue Act of 1936, when the corporation did not cancel or redeem any of its shares but reduced the par value thereof from $100 to $50.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and Regulations are printed in the Appendix, *infra*, pp. 14–18.

STATEMENT

The facts as stipulated (R. 52–71) and as found by the Tax Court (R. 19–27), insofar as they are material to the question presented, may be summarized as follows:

The taxpayer at all times material hereto was a stockholder in the Laredo Bridge Company (hereinafter referred to as the Company) a Texas corporation, the principal asset of which consisted of a toll bridge across the Rio Grande River between the cities of Laredo, Texas, and Nuevo Laredo, Mexico (R. 20, 53). The Company had been incorporated in 1902 with an original capitalization of $150,000, consisting of 1,500 shares of a par value of $100 each (R. 20, 53). On April 25, 1920, a fire destroyed the toll bridge and in order to raise the necessary funds for reconstruction, the capital stock of the Com-

pany was increased to $250,000 by the sale at par of 1,000 additional shares of a par value of $100 each (R. 21, 54). On April 11, 1922, the Company voted to increase its capital stock from $250,000 to $500,000. A 100% stock dividend of 2,500 shares was then declared and paid to stockholders of record out of earned surplus. The purpose of this last increase in capitalization was to reflect the increase in capital assets resulting from the new bridge. (R. 22, 56.)

The bridge owned by the Company was erected and operated under a concession by the Mexican Government and under a permit by the City of Laredo, Texas. The Mexican concession provided that at the end of fifty years the Mexican portion of the bridge should become the property of the Mexican Government, which would pay to the company two-thirds of its then appraised value. (R. 20, 53–54.) The franchise from the Mexican Government expired on June 6, 1937, and the Government then took over the Mexican portion of the bridge at a price of $75,962.28. This amount, less a transfer tax of $85.20, was received by the Company on July 24, 1937. (R. 22, 57, 58.)

On September 14, 1937, the directors of the Company voted to distribute to the stockholders the amount of $135,000, representing approximately the net proceeds of the sale to the Mexican Government and the depreciation reserve attributable

to the Mexican end of the bridge, and instructed the secretary to call a special meeting of the stockholders for the purpose of authorizing a reduction of the capital stock from $500,000 to $250,000 (R. 23–24, 61–62). At a special meeting held on October 12, 1937, the stockholders duly voted to approve and ratify a capital distribution of 27% ($135,000) to all stockholders of record and resolved that the capital stock of the Company be decreased from $500,000 to $250,000 and that the corporate charter be amended accordingly (R. 24–25, 65). The charter amendment was approved by the Secretary of State of Texas on October 23, 1937 (R. 66).

The reduction of the capital stock was accomplished by reducing the par value of each share of stock from $100 to $50 and there was endorsed on the face of each certificate the following (R. 26, 66):

> Authorized Capital Stock Decreased From $500,000 to $250,000 In Accordance With Resolution Of Stockholders At Meeting Held October 12, 1937, Par Value Each Share Reduced From $100 to $50.

Thereafter, the Company continued to operate the American side of the bridge and derived substantial income therefrom (R. 31, 69–71, 79–80).

In the latter part of 1937, the taxpayer and his wife, who reported income on the community

property basis (R. 52), received $23,706 of the $135,000 distributed in accordance with the plan described above, and none of this $23,706 was reported by them as taxable income[1] (R. 26, 66).

Before the Tax Court, the taxpayer contended that the $135,000 distributed by the Company was a capital distribution made in partial liquidation of the corporation under Section 115 (c) and (i) of the Revenue Act of 1936; and alternatively, if the distribution was not made in partial liquidation, it was a distribution out of capital, except for $45,006.73 thereof paid out of accumulated earnings, and should be applied to reduce the cost basis of his stock under Section 115 (d) (R. 27).[2] The Tax Court decided against taxpayer on both issues (R. 27–40), and the Circuit Court of Appeals affirmed the decision in both respects (R. 87–93). Only the holding with respect to whether the distribution was one in partial liquidation is involved in the petition for certiorari.

---

[1] The same question as is involved in this case is presented in the case of the wife, now pending before the Circuit Court of Appeals. It was ordered by the court that her case is to be controlled by the final decision in the instant case (R. 82–83).

[2] The same contentions were made with respect to a distribution of $90,000 made in 1937 (R. 27), which the Company reported as a taxable dividend (R. 26). The Tax Court held against the taxpayer with respect to this distribution, and the taxpayer did not petition for a review of the holding by the Circuit Court of Appeals (see R. 47–50). Accordingly, the nature of this distribution is not before the Court.

ARGUMENT

The distribution of $135,000 was made out of accumulated earnings and profits (R. 92–93) [3] and is a taxable dividend under Sections 22 (a) and 115 (a) of the Revenue Act of 1936 (Appendix, *infra,* p. 14), unless it was a distribution in partial liquidation, as the taxpayer contends. If it was an amount distributed in partial liquidation, it is to be treated as a partial or complete payment in exchange for the stock. Section 115 (c) of the Revenue Act of 1936, *infra,* pp. 15–16.

Section 115 (i) defines the term "amounts distributed in partial liquidation" as—

> a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Since there was not a "series" of distributions in this case but only the one distribution in October, 1937, it is apparent that the first part of the definition is the only pertinent part. The precise question presented by the case, therefore, is whether the distribution of $135,000 was one in

[3] The court below held that the 1922 stock dividend of $250,000 (see Statement, *supra,* p. 3) did not reduce earnings and profits for dividend purposes (see Section 115 (h) of the Revenue Act of 1936) and that the distribution of $135,000 in 1937 must be deemed to have been made from the earnings represented in the 1922 stock dividend (R. 92–93). As indicated, the taxpayer has not made the correctness of this holding an issue in this Court (see Pet. 5).

complete cancellation or redemption of a part of the Company's stock.

There was no complete cancellation or redemption of any of the Company's stock in 1937, but only a reduction in the par value of all of the stock. The stockholders' resolution did not refer to cancellation or redemption of stock but simply authorized a decrease of the stock from $500,000 to $250,000 (R. 65), and this was accomplished by reducing the par value of all stock, rather than by cancelling or redeeming a part of it. After the distribution, the same stockholders owned the same number of shares and had the same proportional interest in the Company's assets. Accordingly, the holding of the Circuit Court of Appeals that there was not a complete cancellation or redemption of any part of the stock is correct and is in accord with *Wilcox* v. *Commissioner,* 137 F. 2d 136 (C. C. A. 9th).[4] See also

[4] The following texts also agree that a reduction in the par value of stock does not constitute a complete cancellation or redemption of any part of the stock under the statute: 1 Mertens, Law of Federal Income Taxation 551; 1 Paul & Mertens, Law of Federal Income Taxation 432; G. C. M. 8175, IX–2 Cum. Bull. 134 (1930).

The taxpayer seeks to distinguish the *Wilcox* case (Pet. 26–27) on the grounds that there the distribution was out of earnings and profits and that the corporation's activities were not curtailed through a sale of part of its assets. But since the Circuit Court of Appeals held that the distribution in this case is deemed to be out of earnings and taxpayer does not attack that holding in this Court, the first attempted distinction is without basis. The fact that assets were not

Article 115–5 of Treasury Regulations 94 (Appendix, *infra,* pp. 17–18), providing that a complete cancellation or redemption of a part of corporate stock may be accomplished by the complete retirement of all shares of a particular series, by taking up all the old shares of a particular series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not *pro rata.*

The taxpayer states (Pet. 21–24) that the holding of the court below is in direct conflict with *Commissioner* v. *Straub,* 76 F. 2d 388 (C. C. A. 3d); *Bynum* v. *Commissioner,* 113 F. 2d 1 (C. C. A. 5th); *Malone* v. *Commissioner,* 128 F. 2d 967 (C. C. A. 5th); and *Patty* v. *Helvering,* 98 F. 2d 717 (C. C. A. 2d). We submit that there is no conflict.

---

sold and the business was not curtailed in the *Wilcox* case is an immaterial difference. A contraction of business may or may not accompany a partial liquidation under the statute, but in any event the *Wilcox* case does not stand for the principle that every distribution following a partial contraction constitutes a partial liquidation. Cf. *Baker* v. *Commissioner,* 80 F. 2d 813 (C. C. A. 2d), and *Tate* v. *Commissioner,* 97 F. 2d 658 (C. C. A. 8th), certiorari denied, 305 U. S. 639, in which distributions by a corporation, even though from the proceeds of the sale of capital assets, were held not liquidating distributions since no cancellation or redemption of stock occurred.

The *Bynum* and *Straub* cases did not involve the question whether a single distribution was in complete cancellation or redemption of a part of stock, as does the instant case, but whether the distribution in question was "one of a series of distributions in complete cancellation or redemption of all * * * of its stock" under Section 115 (i).[5] In the *Malone* case, the capital of a corporation was reduced by calling in all outstanding stock for cancellation and reissuing one-half the number of shares of the same par value to the same stockholders together with cash. This constituted a partial liquidation under Article 115–5 of the Treasury Regulations. The *Malone* case, therefore, does not hold that a reduc-

[5] In both cases, the corporate resolution referred to the distribution as a liquidating dividend made in the process of discontinuing the business. Where a distribution is one of a series in cancellation of stock, it is manifestly not required that the stock be cancelled until it is entirely redeemed. And although a distribution made as one of the steps in the actual retirement and cancellation of all the stock is not prevented from being made in liquidation because no stock is then actually cancelled, it does not follow that a mere reduction in par value constitutes a cancellation or redemption when the very issue is whether stock has been cancelled or redeemed by such reduction. Moreover, the *Bynum* case did not involve a reduction in par value of stock but is a case where the amount of the liquidating distribution, which was one of a series of distributions, was endorsed on the stock certificates.

tion in par value constitutes a redemption or cancellation of stock. Nor does the *Patty* case so decide. There it was merely assumed by the court (p. 718), since no argument to the contrary was presented, that a reduction in par value was a complete cancellation or redemption of a part of the Company's shares. The issues actually decided were different.[6]

It is asserted (Pet. 24–25) that a partial liquidation must have occurred when a part of each share of stock was cancelled equally as if a part of the total number of shares had been cancelled. We believe that a reduction in par value does not cancel or redeem a part of each share. But in any event, the statute defines partial liquidation as complete cancellation of part of the stock and not as partial cancellation of all the stock. Although the Company could have effected a partial liquidation by completely cancelling one half of its stock, it did not do so; and the tax effect of the transaction must be

[6] In the *Patty* case, the question whether the distributions were in partial liquidation of the corporation was not in issue. The Commissioner, for the purpose of the appeal, assumed that they were, but contended nevertheless that the distribution was out of earnings and profits and taxable as an ordinary dividend under Section 115 (a) and (b), or else was taxable under Section 115 (g) as being "essentially equivalent to the distribution of a taxable dividend," the only questions determined by the court.

governed by what was done and not what might have been done. See *Davidson* v. *Commissioner,* 305 U. S. 44, 46.

The contention (Pet. 20–21, 27–28) that the word "stock" in Section 115 (i) refers to the stockholders' intangible interest in the corporation, rather than stock certificates or shares of stock, is without merit. The administrative construction of the word "stock" is inconsistent with the taxpayer's view (Article 115–5, Treasury Regulations 94) as is *Wilcox* v. *Commissioner,* 137 F. 2d 136 (C. C. A. 9th). But even if the term is assumed *arguendo* to refer to the shareholder's interest in the corporation, there was no complete cancellation or redemption of part of that interest by a reduction in the par value of the stock, for each shareholder retained the same proportional interest in the corporate assets.

The taxpayer attacks (Pet. 14–19) the holding of the court below that the distribution of $135,000 was not one in partial liquidation because there was no evidence that it was made with intent to wind up, or to initiate a process of winding up, the corporate affairs. Since we have shown that the distribution and the concomitant reduction in par value did not effect a complete cancellation or redemption of part of the stock within the statutory definition of a partial liquidation,

it is immaterial whether the distribution was connected with an intent to liquidate or curtail the business.[7] It is true that the decisions in *Commissioner* v. *Quackenbos,* 78 F. 2d 156 (C. C. A. 2d); *Commissioner* v. *Cordingley,* 78 F. 2d 118 (C. C. A. 1st); and *Kelly* v. *Commissioner,* 97 F. 2d 915 (C. C. A. 2d), indicate that a distribution in complete cancellation or redemption of a part of the stock is a partial liquidation even though there was no intent to wind up the corporate affairs in other respects. Cf. *Malone* v. *Commissioner,* 128 F. 2d 967 (C. C. A. 5th). But those cases do not hold that a partial liquidation results where there is no complete cancellation or redemption of any part of the stock, but only a reduction in par value of all the stock as in the instant case. Consequently they do not conflict with the decision below on the controlling issue, even though they may be inconsistent with the deci-

[7] The Circuit Court of Appeals was, however, justified in concluding that the distribution was not made with the intent to wind up, or to initiate the process of winding up, the corporate affairs (R. 92). The sale of the Mexican part of the bridge occurred, not because the Company was curtailing its business, but in order to comply with the terms of its franchise (R. 20, 22). Such a sale was always contemplated from the time the Company commenced to do business as a necessary incident of doing business. After the sale, the Company continued to operate the American side of the toll bridge, earning substantial income, and the record is barren of any indication that discontinuance of that business was contemplated.

sion below as to the necessity for a liquidating intent.[8]

CONCLUSION

The judgment of the court below is correct and presents no conflict requiring a decision by this Court. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
HELEN R. CARLOSS,
HELEN GOODNER,
Special Assistants to the Attorney General.

WALTER J. CUMMINGS, JR.,
Attorney.

JULY 1944.

---

[8] As the taxpayer suggests (Pet. 15), a liquidating intent is manifestly necessary, under the second definition of a partial liquidation contained in Section 115 (i), to prove that a distribution is one of a series of distributions in complete cancellation or redemption of all or a portion of the stock. See, *e. g.*, *Holmby Corp.* v. *Commissioner*, 83 F. 2d 548 (C. C. A. 9th); *Canal-Commercial T. & S. Bk.* v. *Commissioner*, 63 F. 2d 619 (C. C. A. 5th), certiorari denied, 290 U. S. 628; *Neptune Meter Co.* v. *Price*, 98 F. 2d 76 (C. C. A. 2d).